China Economic Review 19 (2008) 537–550

Contents lists available at ScienceDirect

China Economic Review

An economic analysis of China's credit information monopoly

Nicola JENTZSCH *

Technische Universität Berlin, Faculty VII Economics and Management, Networks, Information and Communication Economics, Straße des 17. Juni 135, 10623 Berlin, Germany
Deutsches Institut für Wirtschaftsforschung, Mohrenstraße 58, 10117 Berlin, Germany

A R T I C L E I N F O

Article history:
Received 15 February 2008
Received in revised form 10 June 2008
Accepted 11 July 2008

JEL classification:
K
D82
G21
G28

Keywords:
Information sharing
Credit markets
Regulation

A B S T R A C T

The Chinese government is building the largest public credit information database on earth. The Credit Registry Center of the People's Bank of China registers more than 600 million consumers of which 110 million have a credit relationship with a financial institution. The Center is a public utility monopoly which collects information from banks and non-bank institutions — a unique approach developed in China only recently. In other countries, public credit registers and private credit bureaus co-exist, where the latter are in competition with one another. This article provides the first analysis of the Chinese Credit Registry Center. First, I discuss the development of lending to households, because consumer and mortgage markets came into existence only recently. Secondly, I describe the institutional set-up of the register and its regulation, here, China is compared to other countries. At this stage, there is only very little data available on the register, such that the economic assessment necessarily remains limited. One important question discussed herein is whether the Chinese monopoly can serve as an example for other developing and transformation countries that are currently establishing credit reporting systems.

1. Introduction

In China, the world's largest public credit register emerges: By March 2008, the Credit Registry Center of the People's Bank of China registered more than 600 million consumers, of which 110 million had an established credit relationship with a bank or other financial institution. In 2007, the database on corporations registered more than 13 million companies of which 5.9 million had an established credit relationship. This registry will have considerable impact on the economic life of the Chinese people, but also on credit market development, banking competition and banking performance. For several reasons, this registry is outstanding: its sheer size, the volumes of daily inquiries, the underlying 'social credit' approach, which includes bank and non-bank information on individuals and companies — these features in combination mark its uniqueness. In other countries, especially in Europe, dual systems of public registers and private credit bureaus exist and the latter are in competition with one another.

The database is an important and critical component of the Chinese financial system. Yet, so far there has not been a discussion of its institutional set-up, nor an assessment of its possible economic impact. Although it is the largest public credit register on earth, it is virtually unknown in the Western world. One of the reasons might be the lack of information on it. This paper intends to fill this gap.

Around the world, more and more credit registries are founded and many developing and transformation countries are confronted with the necessity to choose a market organization for credit reporting. One pressing question, which is discussed herein, is whether private competition should be established or whether a public monopoly is the better route. The Chinese government has chosen the monopoly route for several reasons, probably the most important one being the fast growth rates in

* Corresponding author. Tel.: +49 30 89 78 92 34; fax: +49 30 89 78 92 00.
E-mail address: njentzsch@diw.de.

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doi:10.1016/j.chieco.2008.07.003

lending to households and the increasing risks that come with it. Traditionally, the State-owned Commercial Banks in China (SCBs) lent to corporations. This lending was based to a lesser extent on credit risk assessment and profitability, and to a greater extent on specific political goals. Bank loans provided the primary source of funding of unprofitable companies, resulting in high ratios of non-performing loans in the SCBs. Since 1998, the government has actively supported lending to consumers for consumption and housing purposes to diversify the loan portfolio of banks and to improve their profitability. These measures come in combination with others (such as the establishment of Asset Management Companies) to reduce non-performing loans. Although China's household credit market is still small compared with other transformation countries, it grows at double-digit rates.

Credit reporting – the collection and distribution of personal financial information – is an important tool to decrease asymmetric information between creditors and borrowers. Through better monitoring, moral hazard and credit rationing can be mitigated and risk-based pricing can be applied through credit scoring techniques. If interest rates are not fixed, this leads to greater interest rate differentials in the market. The more precise risk assessment improves a bank's portfolio risk management and increases productivity in the banking sector. Credit reporting improves non-performing loan ratios, leads to less losses through write-offs and decreases interest rates for good credit risks. Bad credit risks, however, have to pay a risk premium.

In downstream markets, credit reporting has the effect of intensifying competition through raising transparency between the institutions that share information on their customers. The World Bank typically stresses the positive effects of credit reporting, such as increasing access to finance. However, a centralized economic reputation system can come with considerable privacy risks for individuals and even exclusion from services. First, the information reveals not only a consumers' credit risk, but also their willingness to pay. The data can be used by a financial service provider to set personalized contractual terms and shift rents to the detriment of the consumer. Secondly, if risks associated with individuals are perceived as too high, they might be excluded from services altogether (at least until information is expunged).

This paper provides the first institutional analysis and economic assessment of the credit information monopoly in China. As such, it only naturally suffers from data availability limitations. For instance, there is the very short period of operation of the registry — its nationwide expansion only started in 2005/2006. Secondly, there is only very limited data disclosed (typically only in speeches of Central Bank officials). However, some preliminary indications of the economic impact can be derived from the People's Bank of China's *Corporate Credit Information Database* which started to be populated with data in 2000 and has been in trial operation since 2001. Further, on empirical impact, I include other literature on credit reporting systems. Finally, I discuss whether the Chinese monopoly can serve as an example for other developing and transformation countries.

The paper is organized as follows: Section 2 discusses the latest trends in the household credit market in China. Section 3 presents the institutional design of the register and its regulation. Here, China is compared to other countries. Section 4 provides an early-stage assessment of the impact of the system on lending and discusses whether it can serve as an example for other countries. Section 5 concludes.

2. Expansion of lending to households in China

Over the past 25 years, the Chinese economy has been growing at an enormous pace compared to the world average. Recent statistics show that since 2000, China's GDP has been growing with a real annual rate at 9.74% on average (from 2000–2007) reaching 11.4% in 2007.[1] According to the World Bank, China is now ranked as 4th largest economy, behind Germany, Japan and the United States. The rise of China remains surprising considered the absence of many institutions that typically contribute to economic growth such as rule of law, secure private property or efficient courts (Qian, 2002). Further, typically, financial intermediation also contributes, but in China these effects have been small to even negligible (see Aziz and Duenwald, 2002 and Hao, 2006 for the post-1978 period).

The Chinese government acknowledges credit in its macroeconomic policy strategy as a way to strengthen domestic demand to stimulate economic growth. In the past, the government has made great strides to reform the banking system. Other authors have provided extensive discussions on these reforms, such that only the milestones are mentioned here.[2]

Prior to 1994, the government used the four State-owned Commercial Banks (SOCB) to lend to state-owned enterprises for infrastructure projects or welfare subsidies.[3] In 1994, 3 development banks were established and the SOCB were held to conduct commercial lending. Lending policy, however, remains a point of contention. For instance, by using provincial data from 1991–1997, Parka and Sehrt (2001) find that lending based upon policy considerations by state banks did not fall. And Podpiera (2006) argues that (for the period of 1997–2004), the SOCB did not take enterprise profitability into account. In the past, state intervention in the financial sector was massive. But with the *Commercial Banking Law* in 1995, the government laid down modern legal foundations for banking. There have been steps to liberalize foreign currency and RMB loans. These have improved the soundness and stability of the Chinese banking system.

Today, China's commercial banking system consist of the four SOCB, around 120 licensed commercial banks, approximately 50,000 credit cooperatives in rural areas and other small financial institutions. The Big Four banks still dominate the banking system, they hold more than 60% of the bank assets and own more than 100,000 branch offices. Additional pressure is put on the system due to WTO accession and the pledge to liberalize the financial market. Under the World Trade Organization agreements, China has committed to

[1] These are the official statistics from the National Bureau of Statistics. For a discussion of their quality see Rawski (2001).

[2] On banking sector reform, see Garcia-Herrero, Gavila and Santabarbara (2005).

[3] The four large state-owned banks in China, the so-called 'Big Four' are the Bank of China (BOC), the Agricultural Bank of China (ABC), the China Construction Bank (CCB) and the Industrial and Commercial Bank of China (ICBC).